



MINUTES

Electronic Commerce Study Committee

December 21, 2012

MEMBERS PRESENT:

Senator Matt McCoy, Co-chairperson
Senator Tom Rielly

Representative Chuck Soderberg,
Co-chairperson
Representative Chris Hall
Representative Tom Sands

MEETING IN BRIEF

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I. Procedural Business

Call to Order. The first and only meeting of the Electronic Commerce Study Committee was called to order at 10:10 a.m. on Friday, December 21, 2012, in Room 103 at the State Capitol Building in Des Moines, Iowa by temporary Co-chairperson Soderberg. The meeting was adjourned at 12:45 p.m.

Election of Permanent Co-chairpersons. Members of the committee unanimously elected temporary Co-chairperson McCoy and temporary Co-chairperson Soderberg as permanent co-chairpersons.

Adoption of Rules. Members of the committee adopted procedural rules which are posted on the committee's Internet site.

Committee Charge. The charge of the committee is to collect information from stakeholders relating to the collection of sales and use taxes from local and Internet-based retailers (known as "E-fairness") and the collection of electronic payment transaction interchange fees (known as swipe fees).

Welcome. Co-chairperson Soderberg welcomed members of the committee and noted that committee member Feenstra was unable to attend the meeting.

II. Internet Sales Taxation — National Conference of State Legislatures (NCSL)

Mr. Max Behlke, Manager of State-Federal Relations, NCSL, provided, via telephone link, an overview of online sales taxes from both a state and federal perspective. Mr. Behlke cited a United States Supreme Court ruling holding that states cannot force out-of-state retailers to collect state sales taxes owed by consumers for catalog or Internet sales transactions because such tax collection would put an undue burden on interstate commerce. This situation puts local merchants and the states at a disadvantage which is increasing with the continued expansion of electronic commerce. Mr. Behlke identified several options for states seeking to increase revenue collected from electronic commerce sales and use taxes, including becoming a member of the Streamlined Sales Tax and Use Agreement, passing an affiliate nexus or "Amazon law," enacting notice laws that require a remote vendor to provide information about sales and use tax obligations to buyers, urging Congress to pass legislation that would give states remote tax collection authority, and entering into tax collection agreements on an individual basis with specified large-scale Internet retailers.

Mr. Behlke said that the bottom line is that states will never be able to collect the full amount of taxes on electronic commerce that are owed to them without federal action. He summarized proposed federal legislation designed to confer sales and use tax collection authority on the states such as The Main Street Fairness Act, The Marketplace Equity Act, and The Marketplace Fairness Act. He indicated that sponsors of such legislation in both chambers of Congress have made passage a priority.

In response to questions from committee members, Mr. Behlke said that the proposed federal legislation will be about fairness and how taxes are collected, not rates or which items are taxed,



and will be revenue-neutral as far as the states are concerned. There is little state action required except for including projected tax collections in state budgets and encouraging each state's federal elected officials to support the proposed legislation. While Governor Terry Branstad and Senator Tom Harkin have expressed support for the legislation, Senator Chuck Grassley has indicated that he would vote for it as part of a package, although he would not cosponsor such a proposal.

III. Electronic Payment Transaction Interchange Fees — NCSL

Ms. Heather Morton, Program Principal, Fiscal Affairs, NCSL, provided, via telephone link, a corresponding federal and state overview relating to the issue of electronic payment transaction interchange fees. Ms. Morton described how an interchange fee works, indicating that when a consumer uses a credit card to make a purchase, a portion of the transaction amount is deducted and distributed among three entities: the financial institution that issued the credit card, the merchant's financial institution, and the credit card network that processes the transaction.

She discussed the impact of Section 1075 of the federal Dodd-Frank Act which became law on July 21, 2010, (the Durbin Amendment) on debit card interchange transaction fees and identified exemptions to the amendment's provisions (most notably any issuers having assets of less than \$10 billion). The amendment gave the Federal Reserve authority over interchange transaction fees and provided that the fees must be "reasonable and proportional to the cost incurred by the card issuer with respect to the transaction" and limited payment card network restrictions. In July 2011 the Federal Reserve adopted regulations to implement the Durbin Amendment. Proponents of the new regulations claim that merchants' costs have been lowered as a result, that loss of bank rewards and other services is not due to the regulations, and now propose that the cap on interchange fees should be extended to credit cards.

Ms. Morton discussed interchange fee legislative activity at the state level, indicating that between 2005 and 2012 a total of 122 bills and resolutions have been introduced addressing one or more issues involving interchange fees. Of this total, 10 resolutions and three bills have been enacted. Only Vermont has enacted substantive legislation pertaining to interchange fees. Ms. Morton also identified states which have introduced legislation relating to exempting sales and use taxes from interchange fee calculations, similar to legislation introduced in Iowa during the 2012 Legislative Session.

IV. Iowa Department of Revenue (IDR)

Ms. Victoria Daniels, Administrator of Tax Policy and Communications, IDR, and Dr. Amy Harris, Manager, Tax Research and Policy Analysis Section, IDR, provided information from the department's perspective regarding the Internet sales taxation issue. Ms. Daniels reiterated that because of the federal Supreme Court holding that allows collection of sales and use tax by a state only when there is a nexus or presence of the retailer in the state, there must be federal action for that holding to be overruled. She said that federal legislation is the best course of action in order to avoid piecemeal attempts to deal with the issue.

Ms. Daniels suggested some issues Iowa will need to consider if federal legislation is enacted including when the state can begin tax collection, anticipating at least a 90-day lag between enactment of the legislation and when retailers must begin to collect and remit the sales and use



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taxes; whether, and in what amount and format, the state will compensate remote retailers for their efforts; whether there will be an exception for small sellers with nationwide sales of less than \$500,000; and what technology and infrastructure the state will need to receive the revenue that the state is entitled to.

In response to Mr. Behlke's presentation, Ms. Daniels indicated that pursuant to Iowa's membership in the Streamlined Sales Tax and Use Agreement, the state captured at least \$20 million in 2011, not the \$9.4 million indicated by NCSL. Dr. Harris added that IDR is already trying to anticipate what revenue the state might expect if a federal law addressing this issue is enacted.

In response to a question by a committee member, Ms. Daniels said that while most people are not aware of their obligation to pay taxes on Internet purchases, they can currently voluntarily remit what is owed to the state on the IDR Internet site. There is a possibility that if federal legislation is enacted, a big player such as Amazon will, for a small fee, collect taxes for small retailers and remit them to the appropriate states.

V. Iowa Division of Banking

Mr. James Schipper, Superintendent of Banking, stated that the division has no position as a regulator regarding the legislation introduced during the 2012 Legislative Session exempting sales and use taxes from interchange fee calculations. He indicated, however, that the proposed legislation would impose new requirements on the approximately 300 state-chartered banks in Iowa, which range from small to very small in size. A disproportionate burden is placed on small banks when any new regulation is imposed, especially new state regulatory requirements that are only applicable to state-chartered not federally chartered banks, due to federal preemption. He said that the doctrine of federal preemption as to banking regulation is well-established so that when a new state law or regulation is determined to be more burdensome than a federal standard, the law or regulation does not apply to federally chartered banks.

VI. Office of the Attorney General

Mr. Bill Brauch, Director of the Consumer Protection Division, accompanied by Ms. Jessica Whitney, Assistant Attorney General, said that the Attorney General's Office is also neutral on the legislation introduced during the 2012 Legislative Session of the General Assembly. However, Mr. Brauch and Ms. Whitney both expressed their strong concern that the proposed state law would be subject to federal preemption and would only be applicable to state-chartered banks.

VII. Iowa Bankers Association

Mr. Steve Rauchenberger, representing the Electronic Payment Coalition, described the complexity and competitiveness of the national payment card system. He said that the system allows a person to swipe a card internationally and is very secure. There are constant efforts to get retailers to switch processing networks. He opined that there is robust federal oversight of the industry, including antitrust regulation. He has testified in 11 other states on proposed legislation similar to what was introduced in Iowa during the 2012 Legislative Session, concerning the technical complexity of making changes to the system and the possibility of federal preemption of the proposed legislation.



Ms. Sharon Presnell, Senior Vice President, Iowa Bankers Association, repeated the assertion that the proposed 2012 Iowa legislation would likely apply strictly to state-chartered banks. She identified several issues which she contended would prove burdensome to such banks and to retailers and their customers, if the legislation were to be enacted.

Specifically, she stated that the necessary infrastructure to exempt sales and use taxes from interchange fee calculation does not currently exist and would have to be created at a high cost to merchants, processors, networks, and financial institutions. Additionally, a financial institution would bear the credit risk for the entire transaction, including the tax portion, merchants would need specialized terminals and software to itemize and communicate segmented data, and consumers could face paying two separate transactions per sale, one for the product or service, and another for the taxes owed. Ms. Presnell distributed a schematic illustrating how payment card transactions are processed, the variables underlying the cost to merchants of accepting credit and debit cards, and the benefits derived by them from doing so.

In response to questions from committee members, Ms. Presnell responded that approximately 20 percent of Iowa's banks are federally chartered and that the federal Durbin Amendment permits retailers to refuse credit purchases of less than \$10.

VIII. Community Bankers of Iowa

Mr. Mike Hollinger, President and Chief Executive Officer, Shazam, Inc., identified and described the various parties involved in the operation of the payment card network, and stated that while the network is highly specialized and complex, it has a relatively narrow set of payment processing rules, facilitating the network's efficient operation. He described the system as the most efficient payment system in the world and said that it would require significant effort to split transactions into taxable and nontaxable portions and then relink the portions at some later point for payment. He said that requiring such a system would create confusion in the marketplace and a need for complex infrastructure that does not now exist.

Mr. Don Hole, Executive Vice President and Chief Executive Officer, Community Bankers of Iowa, stated that establishing a precedent of determining payment system costs based upon the type of payment is ill-advised. He emphasized that the payment system is voluntarily agreed to and is based on universal acceptance, guarantee, and settlement without respect to transaction type, and expressed concern that designating that certain types of payments must be handled in a unique way increases costs to the financial institution and the consumer, at no cost to the merchant receiving the service, and has the potential to extend to other types of transactions beyond sales tax.

IX. Iowa Credit Union League

Mr. Jeff Russell, The Members Group, said that his organization is owned by the Iowa Credit Union League and processes transactions for smaller financial institutions around the country as well as operating a call center for customers. If Iowa enacts different requirements than other states by requiring separate processing of the sales tax component of a transaction there will be increased retailer and consumer confusion and significant cost to his group to implement the technology necessary to meet those requirements.



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Mr. Justin Hupfer, Vice President of Government Affairs, Iowa Credit Union League, stated that the appropriate venue for any legislation relating to the regulation or calculation of interchange fees is at the federal level, and that the federal legislation which has been proposed is evidence of Congressional intent to exempt small entities and to focus on debit versus credit card transactions. The issue of interchange fees was debated 8-10 years before the passage of the Dodd-Frank Act and all Iowa credit unions and most other credit unions in the United States are exempt from such regulation. He noted that interchange fees are in part designed to help cover some of the financial institution's liability for fraudulent credit card transactions, and that excluding a portion of that transaction is inconsistent with how the electronic payment system is designed to operate. He expressed support for legislation introduced in other states that establishes standards relating to how long electronic data can be stored following the processing of a sales transaction and prescribes merchant liability to financial institutions in the event the standards are not complied with, as a way to combat the important and increasing problem of identity theft.

X. Panel Presentation — Retail Community

Mr. Jim Henter, President, Iowa Retail Federation, summarized the history of interchange fees as beginning more than 40 years ago when big banks began charging retailers and consumers a "swipe fee" to cover the transaction costs of using credit cards. He said that interchange fees are now a hidden expense negatively impacting consumers and business owners. He estimated that Iowa retailers incurred in excess of \$30 million in interchange fees based on retail sales tax collections of almost \$2 billion in 2011, and suggested that if retailers had instead retained these amounts there would have been a positive economic impact and job creation stimulus. Mr. Henter contended that an appropriate infrastructure to facilitate implementation of the proposed Iowa legislation could be readily created based on the fact that there are myriad interchange fees throughout the country that already exist and are tracked. He noted that governmental entities in Iowa already impose a surcharge to cover electronic payment processing costs on taxpayers who use credit cards to pay various fees. For all of these reasons, he indicated that the retail community supports the proposed Iowa legislation to prohibit interchange fees on the tax portion of transactions.

Mr. Craig Walter, Executive Vice President, Iowa Lodging Association, identified interchange fees as a significant cost of doing business for the lodging industry, which collects both sales and use tax and local option sales taxes for a combined 12 percent tax rate. He estimated that 80 percent of customers in the lodging industry use credit or debit cards to pay their bills, one of the highest uses of those cards in the business world. He echoed Mr. Henter's comments regarding the positive economic impact and business expansion opportunities which would be facilitated by the proposed Iowa legislation.

Mr. Will Rogers, Director of Governmental Affairs, Iowa/Nebraska Farm Equipment Dealers Association, estimated that association members incur a minimum of \$500,000 in interchange fees annually based on sales tax collections, and agreed that the money now spent on such fees would be better invested in business expansion opportunities.

Ms. Jessica Dunker, President and Chief Executive Officer, Iowa Restaurant Association, stated, via a letter submitted to the committee, that her association represents Iowa's more than 6,000



restaurants and bars that employ 10 percent of the state's workforce and are the second largest private sector employer category after healthcare. Under the current system Iowa's hospitality operators, like other retailers, act as the state's tax collectors and pay a fee for doing so. She estimated that the average restaurant incurs more than \$1,100 in interchange fees charged on sales tax per year, which could otherwise be used to cover the cost of food for a full day of operation, new equipment, or employee salaries with a cumulative financial impact on Iowa's hospitality industry of nearly \$4 million annually. She said that enacting the proposed legislation would be significant evidence that Iowa is seeking creative solutions to fuel growth and investment in hospitality and other retail businesses.

Mr. Gray Taylor, Executive Director, Petroleum Convenience Alliance for Technology Standards, stated that convenience stores can be characterized in general as selling the most heavily taxed items and that the impact of interchange fees on the sales and use tax portion of their retail sales transactions is in the multiple millions of dollars. Mr. Taylor provided a handout giving a financial snapshot of the convenience and petroleum store industry, the extent to which the industry constitutes a key source of tax revenue, and interchange fee breakdowns. He said that 97 percent of the cost of credit card use is pushed off on the consumer and that swipe fees are set by the credit card companies, not the banks. Credit card companies like Visa and MasterCard are not federally chartered and are not regulated the same way as banks. Mr. Taylor said that retailers spend a lot to maintain the credit apparatus required by the credit card companies, and banks and retailers pay for fraud control. Mr. Taylor opined that the issue of imposing and calculating interchange fees is not fundamentally a banking issue, but is instead determined by the credit card companies. In response to a question by a committee member, Mr. Taylor opined that the federal Dodd-Frank legislation doubled the complexity of swipe fees instead of simplifying the issue. A question was also raised about why no credit card companies were present to participate in this meeting. Co-chairperson Soderberg responded that the Legislature is still collecting information.

XI. Committee Discussion

Co-chairperson McCoy thanked the participants for their attendance especially given the weather and the busy time of year. He said that the Legislature will consider the Attorney General's advice on the impact of any state laws proposed and observed that the ultimate potential payor of any fees is the consumer, although the consumer does have the choice as to how to pay for a purchase. Co-chairperson Soderberg agreed that in the future it would be a good idea to hear the viewpoints of the various credit card companies.

XII. Materials Filed With the Legislative Services Agency

The materials listed were distributed at or in connection with the meeting and are filed with the Legislative Services Agency. The materials may be accessed from the "Committee Documents" link on the committee's Internet site:

<https://www.legis.iowa.gov/Schedules/committee.aspx?GA=85&CID=850>



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1. Tentative Agenda.
2. Electronic Commerce Study Committee.
3. Statement — Petroleum Marketers and Convenience Stores of Iowa (submitted post-meeting).
4. Committee Charge.
5. Committee Member Contact Information.
6. Proposed Committee Rules.
7. Online Sales Taxes — National Conference of State Legislatures Presentation.
8. Collection of Iowa Sales and Use Tax From Local and Internet-based Retailers.
9. Interchange Fees — General Information Articles.
10. House Study Bill 666 — Interchange Fee Bill Introduced During the 2012 Legislative Session.
11. Background Information — Legislative Services Agency, Legal Services Division.
12. Interchange Fees — National Conference of State Legislatures Presentation.
13. Interchange/How Payments Work — Iowa Bankers Association.
14. Committee Remarks — Community Bankers of Iowa.
15. How Payments Work — Community Bankers of Iowa.
16. Opposition to State Regulation of Interchange — Iowa Credit Union League.
17. Committee Remarks — Iowa Retail Federation.
18. Interchange Rate Schedule — Iowa Retail Federation.
19. Committee Remarks — Iowa Restaurant Association.
20. Handout — Petroleum Convenience Alliance for Technology Standards.
21. Extending Sales Taxes to Digital Goods and Services — Iowa Department of Revenue (submitted post-meeting).